| | |
|---|---|
| Date: | Mar 29, 2006 |
| Proposal: | Interagency Guidance on Nontraditional Mortgage Products |
| Document ID: | OP-1246 |
| Document Version: | 1 |
| Release Date: | 12/20/2005 |
| Name: | Richard C Insley |
| Affiliation: | APR Systems, Inc. |
| Category of Affiliation: | Commercial |
| Address: | Box 37176 |
| City: | Richmond |
| State: | VA |
| Country: | UNITED STATES |
| Zip: | 23234 |
| PostalCode: | n/a |

Comments:
Thank you for the opportunity to offer comments on the proposed Interagency Guidance on Nontraditional Mortgage Products (Guidance.) The agencies are to be commended for calling attention to the extensive risks associated with nontraditional mortgage products (NMPs.) I am a banking consultant, former banker (16 years), and former regulator (11 years, Federal Reserve Bank of Richmond.) I have worked with the full range of banking regulations continuously since 1970. APR Systems, Inc. provides consulting services relating to Internet banking, financial calculations, and Regulation Z. My comments are limited to the regulatory aspects of the Guidance. The Guidance observes that NMPs are more complex than traditional fixed-rate and adjustable-rate products, presenting greater risks of payment shock and negative amortization. To reduce these risks, the Guidance would encourage institutions to provide clear and balanced information about the relative benefits and risks of these products. This information would be provided at a time that will help consumers' decision-making processes. Consumers can not make intelligent choices unless they have access to complete information at the very beginning of the decision-making process. Using web-based rate sheets, consumers can evaluate hundreds of price quotes by competing mortgage lenders and quickly focus on the deals that are most attractive. Smart credit shoppers will winnow the list considerably before commencing the complex and costly mortgage application process. Information about NMPs will be of little value if delivery is delayed until the consumer has already deselected the majority of competing lenders. MANDATORY NMP ADVERTISEMENTS The easiest way to assure the availability of clear and balanced information is to mandate Regulation Z-compliant advertisements for NMPs. Since Regulation Z's advertising rules have been in place for decades, lenders would not be required to shoulder a new regulatory burden, consumers would not have to master a new set of disclosures, and the agencies would not have to change current compliance examination procedures. Mandatory advertisements of NMPs would follow Regulation Z's current requirements. Lenders would compute and display blended APRs and the payment streams representative of their NMPs. Since they would be governed by Regulation Z, mandatory NMP advertisements would have to reflect rates and terms actually offered, and would be presented at the earliest point of contact with a potential borrower. The payment schedules included in

mandatory NMP advertisements would reveal the effects (including negative amortization) of the expiration of temporary teaser rates and payments, and also the impact of rate and payment caps, ceilings, and floors. For mandatory NMP advertisements to achieve the desired result, advertising compliance levels will need to improve substantially. All too often credit advertisements, particularly for ARM loans, do not comply with Regulation Z. Most often, the all-important payment schedule examples are missing or reduced to just the teaser payments (omitting the stepped up payments that occur when teaser pricing expires.) Given the fact that the advertising rules are not new, a modest increase in enforcement should clean up violations rather quickly. In order to offer you some measure of the extent of this problem, I selected 20 web sites at random (10 banks and 10 credit unions) for review. The list of sites was produced by a Google search using the selection criteria of ARM +APR +points +"member FDIC" (to retrieve a list of banks) or +"NCUA" (to retrieve the list of credit unions.) All 20 sites displayed ARM advertisements, but none complied fully with Regulation Z. My sample was very small, but experience suggests that a 100% error rate is not far off the mark. Details are available upon request. CAPITAL REQUIREMENTS The Guidance encourages institutions to maintain capital commensurate with the risk characteristics of NMP portfolios. Since many lenders originate loans for non-recourse sale on the secondary market, the window of exposure to credit losses should be limited to the loans in a lender's pipeline. By comparison, the window of exposure to penalties for non-compliance is not limited to loans in the pipeline. Faulty disclosure practices expose lenders to penalties for up to three years. As a condition of sale, lenders must certify each loan to be compliant with all applicable laws and regulations. These agreements require sellers to repurchase any loans found to be noncompliant. Under the Truth in Lending Act penalties could apply for up to a year after most disclosure errors and up to three years for certain disclosure errors in transactions subject to the right of rescission. The cumulative exposure from ongoing Truth in Lending violations could be quite substantial. In addition to the unplanned expense of repurchasing defective loans, the seller would be required to foot the cost of corrective action (including restitution) and pay any penalties. Given the complexity of NMPs, disclosure errors are more likely than in traditional mortgage products. The agencies would be wise to consider imposition of higher capital requirements for NMP originators with a history of Truth in Lending violations. IMPLEMENTATION OF GUIDANCE The agencies have many means of encouraging fair, non-deceptive business practices among insured financial institutions. Regulated institutions and supervisory examiners react to guidance and "optional" regulations in many ways. Some ignore guidance while others treat it as if it were law. If the agencies want a uniform outcome, this initiative should be elevated to the status of a regulation. Once again, thank you for the opportunity to participate in this important exercise. Please feel free to contact me for additional details or discussion of my suggestions. Respectfully yours, Richard C. Insley President richard@aprsystems.com